

SB 281 – Tax Simplification for Married Couples (Sen. Joe Balyeat, CPA)

This bill simplifies income tax filing for married couples filing separate MT returns. Current tax law contains an unnecessary, unfair, and illogical default to federal filing status. The bill attempts to correct MT's unfair disallowance of IRA deductions, education deductions, rental losses, and capital losses. I'll walk through an example using rental losses, but the example illustrated also occurs with IRA deductions and these other deductions as well.

Federal law permits you to deduct up to \$25000 of rental losses if your joint income is below a certain level. But when married couples file separate federal returns, federal disallows their entire rental loss because the feds can't easily track whether or not your combined marital income exceeds the cutoff level.

Yet even if a couple files their federal return jointly to qualify for the rental loss, they still lose that rental loss on their MT return if they file separately. The Dept of Revenue has argued in the past that this is necessary because of the federal joint return requirement. But the only reason the federal requirement is there is so that the feds can check your combined income to see if you exceed the cutoff income limit for rental losses. By the time you get around to doing your MT return, the allowable amount of your rental loss has already been established. So there's no logical reason to also enforce the joint filing requirement on your MT return.

Moreover, because MT law only has one rate schedule for married joint and married separate, MT law virtually forces all two-earner couples to file separate returns. Thus, they're unfairly punished just because of a quirk peculiar to the Montana income tax system.

And here's the frosting on the cake:

Disallowed rental losses are added to your tax basis. Since the loss is only disallowed on the Montana return, and not the Federal return, tax-preparers end up having to keep two sets of books ad-indefinitum from year to year. And when you finally sell the rental house, you have a different gain or loss on sale for federal purposes than you do for state purposes. More complications. This is a nightmare for taxpayers and an accountant's retirement plan.

If you pass this bill, it will greatly simplify the whole process. This bill says that regardless of whether you file jointly or separately on Montana, you get the exact same rental loss deduction as you got on your federal return. This is obviously simpler, and would eliminate the need to keep two sets of rental records.

This is also obviously fairer, because the feds have already made a fair determination of your allowable rental loss at the federal level based upon your joint income, and there is no justifiable reason to further reduce it at the state level.

Now, I went through an explanation of the bill using only rental losses in order to simplify it for you. In addition to rental losses, this exact same problem also occurs in MT with respect to some IRA retirement deductions, capital loss deductions, tuition deductions, and other passive losses. Unfair penalization of two-worker families, complicated tax returns, and duplicate tax records each year ad-nauseum. This bill fixes each of these issues the same way it fixes the rental loss problem. Whatever deduction you got on your federal return, you also get on your MT return regardless of filing status.

The fiscal impact of this fix is relatively small; and clearly justifiable given the fact that the current rule unfairly penalizes two-income families.